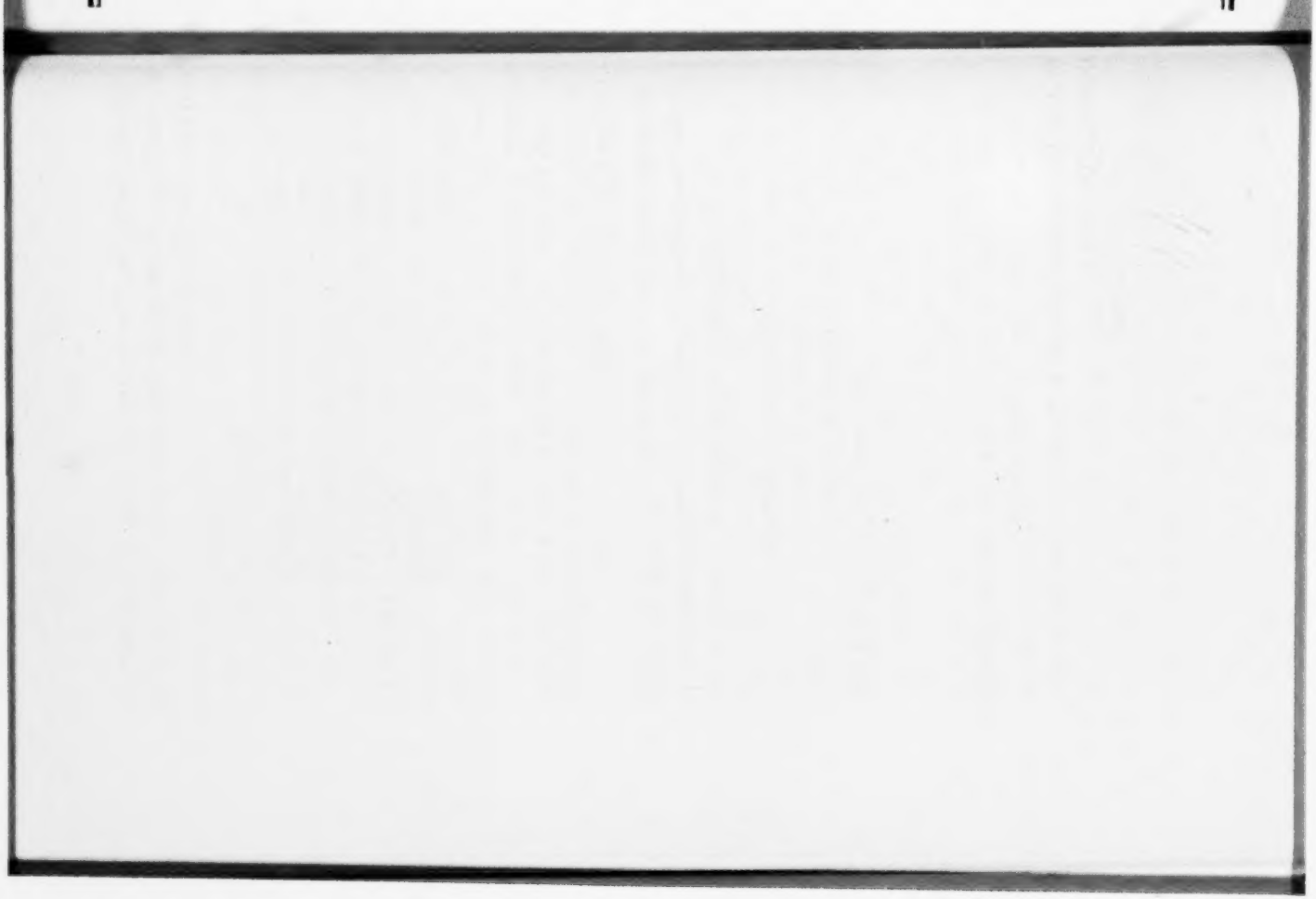

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

Nos. 34-35-36.

In the Matter of

CHICAGO AND NORTH WESTERN RAILWAY COMPANY,

Debtor.

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, Debtor,

Petitioner,

vs.

MUTUAL SAVINGS BANK GROUP COMMITTEE, et al.,

Respondents.

MOTION FOR PERMISSION TO FILE ATTACHED SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

HELEN W. MUNSERT,
LUTHER M. WALTER,
Attorneys for Chicago and North Western Railway Company, Debtor, Petitioner.

April 1, 1943.

BARNARD & MILLER, 33 S. Market St., Chicago. FRAnklin 0562

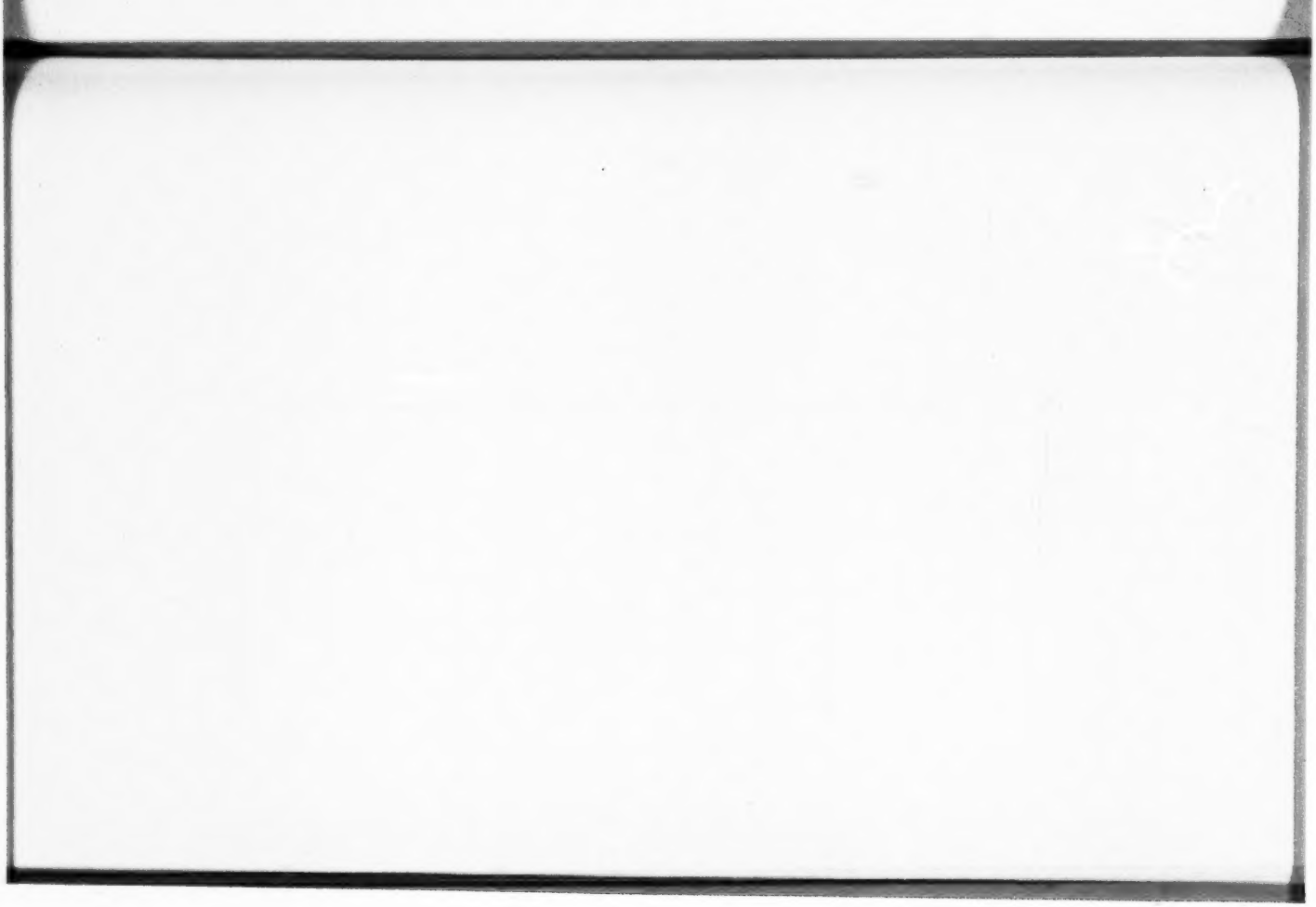

TABLE OF CONTENTS.

	PAGE
Motion	1
Supplemental Brief in Support of Petition for Writs of Certiorari	5
Foreword	5
Debtor's objections to plan of reorganization	7
Objection No. 1. Maximum capitalization	7
Objection No. 2. Value of equity of Debtor's preferred and common stock	17
Objection No. 6. The treatment accorded to the Reconstruction Finance Corporation is unfair and inequitable	18
(a) The amount of securities allotted to Reconstruction Finance Corporation is excessive	18
(b) Treatment of other creditors compared with Reconstruction Finance Corporation	23
(c) The reorganized company should have the right to redeem collateral of Reconstruction Finance Corporation	26
(d) Reconstruction Finance Corporation should not receive any outright unconditional conveyance of securities fee of lessening effect on its claim	27
(e) The proposed agreement submitted under date of July 19, 1940, by the Reconstruction Finance Corporation for release of all securities of the reorganized company by payment of a cash sum, is evidence of the excessive character of the securities allotted to the Reconstruction Finance Corporation	29

PAGE

Objection No. 7. Duplication in allowances for interest on Reconstruction Finance Corporation claim 31

Objection No. 8. Alternative treatment of Reconstruction Finance Corporation..... 32

Objection No. 9. Finance committee..... 34

Objection No. 10. Voting trust..... 34

Objection No. 11. Reorganization managers 35

Objection No. 12. Rehabilitation program.. 35

Objection No. 13. Earnings in normal year, and Objection No. 14. Additional prospective earnings not considered by the Commission 36

Objection No. 15. Common stock reserved for general creditors 37

Objection No. 16. Debtor's pension system.. 37

Objection No. 17. Determination of value of Debtor's properties 37

Objection No. 18. Refusal of Commission to consider plan of consolidating properties of Debtor and Chicago, Milwaukee, St. Paul and Pacific Railroad Company..... 38

The modifications in the plan of reorganization made by the District Court should have been referred to the Interstate Commerce Commission for embodiment in such plan..... 38

Claims for equitable treatment..... 41

The effective date of plan of reorganization herein should be fixed at June 28, 1935..... 42

Confirmation of the plan..... 47

The tax burden vitally affects the plan of reorganization and should be further considered by the Commission 48

Conclusion 51

Table of Cases Cited.

PAGE

Case v. Los Angeles Lumber Products Co., 308 U. S. 106 48

Carey v. Donohue, 240 U. S. 430..... 46

Chicago & North Western Railway Company Reconstruction Loan, 202 I. C. C. 347, 349.....12, 13

Consolidated Rock Products Co. v. DuBois, 312 U. S. 510 6

Ecker et al. v. Western Pacific Railroad Corporation et al. 2, 5

Group of Institutional Investors et al. v. Chicago, Milwaukee, St. Paul & Pacific Railroad Company et al. 2, 5

Northern P. R. Co. v. Boyd, 228 U. S. 482..... 6

Pennsylvania Railroad Company v. International Coal Mining Company, 230 U. S. 184, 198..... 46

Securities of Louisville & Nashville R. R., 76 I. C. C. 718, 720 9

Stock of Delaware, Lackawanna & Western R. R., 67 I. C. C. 426, 433..... 9

U. S. v. Delaware & Hudson Co., 213 U. S. 336, 414.. 46

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1942.

Nos. 34-35-36.

In the Matter of

CHICAGO AND NORTH WESTERN RAILWAY COMPANY,

Debtor.

CHICAGO AND NORTH WESTERN RAILWAY COMPANY, Debtor,

Petitioner,

vs.

MUTUAL SAVINGS BANK GROUP COMMITTEE, et al.,

Respondents.

MOTION FOR PERMISSION TO FILE ATTACHED SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Counsel for petitioner respectfully move for permission to file the supplemental brief attached hereto in support of

petition for writs of certiorari, and in support thereof show as follows:

On March 15, 1943, this Court handed down its decisions in Docket Nos. 11-19, 32, *Group of Institutional Investors et al.* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company et al.,* and Docket Nos. 7, 8, 20, 33, and 61, *Ecker et al.* v. *Western Pacific Railroad Corporation et al.,* in which important principles of law and procedure affecting reorganization of railroad companies under Section 77 of the Bankruptcy Act are enunciated. Counsel for petitioner herein desire to submit certain observations as to the effect which such decisions may have upon the disposition of the petition for writs of certiorari herein.

These proceedings relate to a plan of reorganization of the Debtor, Chicago and North Western Railway Company, under Section 77 of the Bankruptcy Act. A number of questions involved in these proceedings are related to, or are similar to, questions considered and disposed of in the two decisions above named, but many important questions involved in these proceedings did not exist in those cases and should be considered and specifically passed upon by this Court.

The two decisions above referred to do not dispose of the objections raised by the Debtor to the plan of reorganization which was approved by the District Court on October 12, 1940 (Tr. 5072), nor do these decisions dispose of the objections to the decree of the District Court of June 27, 1941, confirming the plan of reorganization of the Debtor. (Tr. 5591)

The questions involved in the two appeals from the orders of October 12, 1940, approving the plan of reorganization and of June 27, 1941, confirming the plan of reorganization are important and their determination should

be helpful in other proceedings for reorganization of railroads.

WHEREFORE, request is respectfully made that the supplemental brief attached hereto be received and considered in connection with said petition for writs of certiorari.

HELEN W. MUNSERT,
LUTHER M. WALTER,
Attorneys for Chicago and North Western Railway Company, Debtor,
Petitioner.

Dated at Chicago, Illinois,
April 1, 1943.

SUPPLEMENTAL BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

Foreword.

The decisions of this Court on March 15, 1943, in Docket Nos. 11-19, 32, *Group of Institutional Investors et al.* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Co. et al.*, and in Docket Nos. 7, 8, 20, 33 and 61, *Ecker et al.* v. *Western Pacific Railroad Corp. et al.*, had relationship primarily to the facts of record in each case, and where, as here, there is a different set of facts, the principles announced in those cases may not have complete application. In this brief we are undertaking to emphasize the points involved in the instant application for writs of certiorari which are not controlled by the opinions of this Court in said two cases.

Petitioner seeks a reversal of the decision of the Circuit Court of Appeals for the Seventh Circuit affirming the decree of the District Court of October 12, 1940, approving the plan of reorganization of the Debtor, and of the decree of June 27, 1941, confirming such plan of reorganization.

There is a fundamental fact which must be kept constantly in mind in determining the various legal and administrative questions in every plan of reorganization of a railroad company. All the operating revenues of the railroad company are determined by the same administrative body, the Interstate Commerce Commission, that prepares the plan of reorganization; such plan must in a very large measure depend upon the revenues which the Commission permits the railroad company to receive. In other words, the Interstate Commerce Commission is responsible pri-

marily for the corporate structure, for the revenues, and in a large measure for the expenditures of the company. Thus, the Commission, in the long run, is responsible for the financial plight of any of the interstate railroads of this country.

Debtor's petition under Section 77 was filed because of its inability to pay interest on its outstanding debt securities, and it sought to effect a plan of reorganization. Had the interest on its debt been contingent upon earnings, no such proceeding would have been necessary. There has been no finding, either of a court or the Commission, that the Debtor is insolvent. The rights of investors in securities of a public utility, subject as these public utilities are to Governmental regulation, should not be disposed of on the primary basis of earnings thus controlled. If the Government may of right determine through rate-making and other regulation how much a utility will be allowed to earn, then it should not force the earnings which it permits, to be the controlling basis for capitalization to be issued to investors. We think that Congress intended by Section 77 to reorganize railroad corporations unable to meet their debts as they mature, by a minimum change in capital structure which would enable the corporation to continue as a public utility. By change in rate and character of interest, whether fixed or contingent, a new plan of reorganization can always be effected without changing priority of debt or in any way violating the recognized principles such as set forth in *Northern P. R. Co.* v. *Boyd*, 228 U. S. 482, and in the case of *Consolidated Rock Products Co.* v. *DuBois*, 312 U. S. 510.

Debtor's Objections to Plan of Reorganization.

Debtor's objections to the plan of reorganization were eighteen in number and are set forth at pages 42 to 44, inclusive, of the Petition and Brief in Support of Petition for Writs of Certiorari herein, and more fully in the transcript at pages 4000-15. These objections have not been passed upon by this Court and we think it important to call them to the Court's attention so that they may be, since they raise points appearing in many railroad reorganizations.

Objection No. 1. Maximum Capitalization.

The plan of reorganization fixed the maximum limits of capitalization at $449,974,309, but the Commission authorized as against the assets as of January 1, 1939, the issue of only $423,774,309; first and general mortgage bonds, Series B, in the sum of $13,100,000 (Tr. 3634), and common stock in a like amount (Tr. 3653), were reserved to finance subsequent expenditure in the rehabilitation and improvement program, and when issued would represent additional capitalizable assets. The District Court affirmed the finding of the Commission as to maximum capitalization. (Tr. 5031)

Moreover, there have been large expenditures during trusteeship since the record before the Commission was closed; how great these expenditures may be is not disclosed by the record. We do know that current assets, principally cash, of the Debtor have increased from $28,533,540 (Tr. 1469) on February 29, 1940, to $89,009,584 on January 31, 1943 (pages 15-16 of Second Motion Further to Supplement Record), an increase of $60,476,044 in assets, a sum much more than adequate to warrant issue of additional securities required to take care of the

$40,790,912, including interest to December 31, 1938, of convertible debentures which did not participate in the Commission's plan. (Tr. 3677)

Then, too, it must not be forgotten that during trusteeship, subsequent to February 29, 1940, and prior to February 1, 1943, there has been redemption of debt in the aggregate amount of $9,248,948 and payments of interest totaling $19,351,456, an aggregate principal of debt and interest payments of $28,600,404. See statement of assets at February 29, 1940 (Tr. 1469), and same at January 31, 1943 (pages 15-16 of Second Motion Further to Supplement Record). Certainly, these changes in financial position and assets warrant remanding of the proceedings to determine whether, in the opinion of the Commission, modification should be made in the certified plan of reorganization.

We are not unmindful of the rule in the *Milwaukee* and *Western Pacific* cases which gives to the Commission vast discretionary powers in determining the capitalization of a reorganized company but we believe that in the instant case the action of the Commission was without adequate support in the evidence and violates recognized principles which the Commission has followed in a number of other cases.

Under date of March 9, 1938, a member of Division 4 of the Interstate Commerce Commission transmitted to all parties to the proceeding a memorandum of its Bureau of Finance concerning total capitalization, fixed charges, contingent charges, and equity of common and preferred stockholders in connection with the plan for reorganization of the Chicago and North Western Railway Company, Debtor. That memorandum formed the basis for the report of the Commission on its final plan of reorganization in these proceedings. In two important re-

spects the report of the Commission departs from the memorandum which was filed in the District Court as Debtor's Exhibit 21. In considering this memorandum it is important to note that it represents the views of the Bureau of Finance which had been in control of the proceeding and, in a sense, performed the functions of a master.

The Commission omits from its report the following paragraph found at the bottom of page 14 of Exhibit 21:

> "The assets of the debtor as carried on the debtor's books of account which are capitalizable as of December 31, 1936, within the limitations announced in *Securities of Louisville & Nashville R. R.*, 76 I. C. C. 718, are approximately $597,449,127, composed of $548,543,132 investment in road and equipment, $379,209 improvements on leased railway property, $2,779,070 miscellaneous physical property, $26,983,539 investments in stocks of affiliated carriers, $18,664,207 working capital and material and supplies, and $99,970 special deposits for mortgaged property sold."

In *Securities of Louisville & Nashville R. R.*, 76 I. C. C. 718, 720, to which reference is made in the memorandum of the Bureau of Finance, the Commission stated that it is "'convinced that a substantial surplus should remain uncapitalized as a support for the applicant's credit, providing for emergency needs, off-setting obsolescence and necessary investments in non-revenue-producing property, and serving as a general financial balance-wheel.'" The quotation is from the statement of the Commission in *Stock of Delaware, Lackawanna & Western R. R.*, 67 I. C. C. 426, 433, cited with approval by the Commission in the *Securities of Louisville & Nashville* case, supra, and to which citation the Commission added the further expression of opinion (page 720):

> "Nor is it true that the nature of the assets which a carrier seeks to capitalize is immaterial. We should

> authorize the capitalization of those assets of the carrier only which have been provided and which are intended for continuing productive use in the service of transportation. Such assets will be hereinafter referred to as 'capitalizable assets.' "

The Commission allowed the issuance of new stock in that case to the amount of $45,000,000, leaving uncapitalized the sum of $29,442,773 capitalizable assets of the Louisville & Nashville.

The Commission's maximum permissible capitalization herein of $423,774,309, exclusive of $13,100,000 of bonds to be sold for cash and $13,100,000 of stock to be allotted to the purchaser of such bonds, for improvement purposes, falls short of the capitalizable assets of the Debtor as of December 31, 1936, as found by the Bureau of Finance, in its memorandum above referred to (Exhibit 21), in the sum of $173,674,818, exclusive of non-carrier property. That memorandum stated the views of the Bureau of Finance as to maximum capitalization as follows (page 30, Ex. 21):

> "Consideration of the existing capitalization, investment, probable capitalizable assets, valuation data, the earnings of the carrier, along with the other facts developed in the hearings, and the capitalizations proposed in plans heretofore presented, leads to the view that the total capitalization which the Commission should find permissible in the reorganization is approximately $468,000,000."

Thus we think we have established that the Commission's maximum limitation of capitalization, as carried into effect under its plan of reorganization, takes capitalizable assets of the present stockholders of the Debtor, Chicago and North Western Railway Company, and transfers them to the new or reorganized company, without any consideration whatever to the stockholders of the

Debtor, thus depriving them of their property in violation of statutory and constitutional rights. The issuance of stock subordinate in kind to that provided for in the authorized capitalization evidencing ownership of such capitalizable assets as found by the Bureau of Finance, would have in no wise deprived the holders of obligations of the Debtor, having priority over the present preferred and common stockholders, of any right to which they are morally, equitably or legally entitled. The total capitalization provided for at the time of reorganization is grossly less than capital assets and in that respect the plan fails to meet the requirements of the law of the land.

In our brief in support of the petition for writs of certiorari, page 45, and appendix, pages 49 and 50, we set forth a comparison of certain data of the Milwaukee and of the North Western. Briefly, it there appears that as of December 31, 1938, the total capitalization of the Milwaukee exceeded its rate-making value by $16,000,000, while the North Western capitalization was $220,000,000 less than its rate-making value. Under the plans of reorganization as of January 1, 1939, the debts of the reorganized companies are practically the same, yet the fixed charges of the Milwaukee are approximately $900,000 greater than the fixed charges of the North Western. The authorized preferred stock of the reorganized companies is practically the same but the authorized common stock of the Milwaukee is approximately $95,000,000 greater than the common stock of the North Western. The authorized debt of the Milwaukee is 40.8 per cent of the total capitalization, while in the case of the North Western the debt is 49.4 per cent of the capitalization. Had the plan of reorganization of the North Western provided that the debt of $222,000,000 bear the same ratio to total capitalization as in the case of the Milwaukee, the total capital stock of the reorganized debtor would have

been $322,000,000, an increase of $96,000,000 over that authorized in the plan of reorganization.

In the case of the Milwaukee, the estimated future "normal earnings" were $15,894,000, which should be compared with the estimated "normal earnings" in the case of the North Western of $14,625,000. While the normal future year earnings were only $1,269,000 greater than in the case of the North Western, the Commission authorized a total capitalization approximately $100,000,000 greater for the Milwaukee than for the North Western.

No dividends had been paid on the stock of the Milwaukee since 1917, but in the case of the North Western, as found by the Commission in *Chicago & North Western Railway Company Reconstruction Loan,* 202 I. C. C. 347, 349, there had been an unbroken record of dividends on its common stock by the North Western prior to the closing months of 1931 over a period of 54 years. No breath of scandal has ever touched the financial structure of the petitioner.

Debtor's contention is that the Commission should fix a capitalization of the new company that gives recognition to the present existing capital including the reasonable investment represented by the physical properties of the company, both common carrier and non-common carrier, and that earnings should be determinative of the kind of security and the character of interest on debt of the new company, whether fixed or contingent.

The action of the Commission in approving the plan of reorganization herein with a maximum capitalization of $423,774,309 is at variance with the action of the Commission approximately eight months earlier than the date of bankruptcy herein, for on October 17, 1934, the Commission in the case of *Chicago & North Western Railway Company Reconstruction Loan,* 202 I. C. C. 347, found the

Chicago and North Western Railway not to be in need of financial reorganization in the public interest at that time, and approved a loan of not to exceed $4,138,000 for the payment of unpaid vouchers, of taxes and interest. In passing on the loan, the Commission said (page 349):

> "Prior to the closing months of 1931 the applicant had an unbroken record of dividends on its common stock over a period of 54 years. *It is reasonably capitalized, as evidenced by an investment of approximately $643,518,851 and capital liabilities in the amount of $527,688,900. Its corporate surplus on December 31, 1933, was $39,387,231.* From 1922 to 1930, inclusive, it earned its fixed charges each year by not less than one and a half times. The evidence is that its financial difficulties began with and are incident to the general depression and have been aggravated by the drouth and the severity of hard times in the vast agricultural territory which it serves. It is possible that its resources may not prove to be sufficient to carry it on and into better times. But its record in the past and the nature of its difficulties are such as to lead us to believe that the applicant's present need is not reorganization of capital structure so much as it is an opportunity with reasonable aid to work out its problems." (Our italics.)

In a decision dated September 29, 1934, less than three weeks earlier than the case just cited, the Commission said, in its findings in *Chicago & North Western Railway Company Reconstruction Loan*, 202 I. C. C. 271, at page 274:

> "The applicant's funded debt outstanding on July 31, 1934, was $347,184,100, including $15,447,200 of reconstruction loans, and capital stock outstanding was $180,869,503. If to the rate-making value as of June 30, 1917, of the property owned by the applicant on December 31, 1930, there be added the net cost of property changes between then and date of valuation, the sum is $642,736,392, adjusted for working capital as of December 31, 1931. This is exclusive of investments of $80,692,410 in other companies